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AIMU

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**Via Telefax and Federal Express**

Department of the Interior
Minerals Management Service
Mail Stop 4700
381 Elden Street
Herndon, VA 20170-4817
Attention: Rules Processing Team

Rules Processing Team:

The American Institute of Marine Underwriters ("AIMU") is a non-profit trade association representing over 90 marine insurers which underwrite over 90% of the marine insurance policies issued in the United States. AIMU members, which insure liabilities arising out of oil spills for offshore facilities, have a substantial interest in the potential impact of the proposed oil spill financial responsibility ("OSFR") regulations on offshore facilities and the marine insurance industry. Although AIMU supports the promulgation of new requirements for demonstrating OSFR under OPA, the American Marine Insurance Market perceives several serious problems with the regulations as currently proposed, and respectfully submits these comments for your review and consideration.

The regulations concerning insurance are seriously flawed in a number of respects, and reflect a lack of understanding about insurance issues in general. Indeed, the proposed regulations at times either completely ignore or wholly misconstrue important customs and practices of the industry. Unless remedied, the end result will be an administrative nightmare. The very purpose of the 1996 amendments to OPA concerning financial responsibility for offshore facilities will be defeated.

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## QUALIFICATIONS FOR INSURANCE COMPANIES

The first serious insurance problem involves the security standards (or, more precisely, the lack thereof) for certain foreign insurance companies. Under the proposed rules, a designated applicant may demonstrate OSFR through the use of insurance. § 253.20(b). In so doing, however, a designated applicant may only use certificates issued by insurers that are either (i) syndicates of Lloyds of London, (ii) members of the Institute of London Underwriters, (iii) foreign or domestic insurers that have achieved a "Secure" rating of claims paying ability in their latest review by A.M. Best's Insurance Reports or Standard & Poor's Insurance Rating Services, or (iv) foreign or domestic insurers that have received another equivalent rating by an acceptable rating service. § 253.29(a).

This proposed section, without explanation, gives certain London insurers a "free pass" by allowing them to become qualified insurers without meeting security standards. All other foreign and domestic providers are not so fortunate, and must meet the aforementioned security requirements before becoming eligible under the proposed regulations. This discriminatory treatment against American marine insurers is inexplicable. Burdened with producing such additional evidence, American insurance companies are placed at a competitive disadvantage vis-a-vis their London counterparts.

The result -- an arbitrary distinction among insurance providers -- has been offered without an underlying rationale and seemingly devoid of evidentiary support. Accordingly, this proposed section should be amended so that London underwriters are required to meet similar security standards. In this way, Minerals Management Service ("MMS") will be able to verify the financial stability of insurance providers without unduly benefitting some of these providers at the expense of others.

American marine insurers have cooperated with federal environmental financial responsibility requirements since their inception. Indeed, the Water Quality Insurance Syndicate ("WQIS") was established by a broad spectrum of domestic marine insurers in response to a request from the federal government. Today, WQIS provides the evidence of financial responsibility to support approximately one-third of the OPA certificates of financial responsibility issued by the Coast Guard. In contrast, certain foreign markets have refused to subject themselves to the rigors of being guarantors under the vessel COFR program. It is for this reason that American marine insurers are shocked this these very foreign insurers would be given the special benefit of insuring under the MMS program without having to meet the same financial security standards as other insurers.

**<u>AMOUNT OF INSURANCE REQUIRED</u>**

In order to preserve their financial viability and assure payment on valid claims, insurance companies must be able to calculate accurately potential risks. Unfortunately, the proposed section relating to worst case oil-spill discharge volumes fosters more confusion than clarity. The resulting uncertainty, in turn, makes it difficult -- if not impossible -- for insurance companies to quantify the risk that they are being asked to undertake.

Before calculating its OSFR amount, a designated applicant must first determine its worst case oil-spill discharge volume. § 253.14. The proposed regulations, however, do not provide a formula for calculating this figure. Instead, § 253.14 refers designated applicants to regulations located elsewhere. Specifically, designated applicants are instructed to use the same method of calculating worst case discharges as they use in preparing oil spill response plans for MMS or other federal agencies under different regulatory programs. Unfortunately, the referenced regulations pertaining to oil spill requirements for Outer Continental Shelf facilities foster confusion by referring, somewhat cryptically, to the use of a thirty-day flow rate. *See* 30 C.F.R. § 254.47 (1997). Consequently, it is unclear whether MMS intends for designated applicants under the proposed regulations to use this thirty-day computation.

MMS must resolve this ambiguity and clearly state whether a one- or thirty-day flow rate should be used in calculating worst case discharge volumes. Clarification on this point is crucial, for if the thirty-day figure applies, many parties will exceed the $35 million dollar level and be required to demonstrate a greater amount of OSFR than was envisioned by MMS. Indeed, the very purpose of the 1996 amendments -- keeping most parties at or below the $35 million level -- would be undermined by such a radical and unforeseen development. Since the stakes are so high, MMS must remove any lingering questions on this issue by explicitly providing for the use of a one-day flow volume in calculating worst case oil-spill figures.

MMS has asserted that very few facilities will require in excess of the $35 million dollar first layer of financial responsibility. Yet the confusion over the calculation of the worst case oil-spill discharge volume puts this MMS assertion in doubt. If a thirty-day volume is to be calculated, the result may be that many if not most facilities will require in excess of $35 million in financial responsibility. This would contravene the intent of the 1996 amendments to OPA, which sought to encourage the provision of financial responsibility. It could also present a serious capacity problem for the industry. Because of the very fine environmental record of the offshore energy industry, the imposition of such high financial responsibility requirements is not appropriate in most instances. We urge MMS to review the method of calculation in order to bring the application of the proposed regulations more in line with Congressional intent. Lack of capacity to support previous MMS proposals was a driving force behind the 1996 amendments. The proposed regulations should reflect this concern.

**INSURANCE POLICY LAYERING**

Lingering questions are also present when one turns to the subject of layering. Under the regulations as proposed, insurance provided to MMS may be divided into no more than four layers (e.g., three levels of $35 million and one final level of $45 million). If the amount of insurance is $35 million or less (which should usually be the case), layering among insurance companies is forbidden. Upon careful examination, it becomes apparent that there is a serious problem with this provision.

Specifically, it arbitrarily demarcates the levels at which insurance may be layered, thereby preventing market forces from deciding how to properly allocate oil spill liability risks. Although this market-altering framework may alleviate the administrative burdens placed on MMS, it will be disruptive for insurance markets, which aren't accustomed to subscribing to policies in this manner. From the insurance industry's perspective, it would be much more efficient to instead follow normal market practices. The artificial imposition of arbitrary layers will only serve to discourage insurers from participating as guarantors. This rigid, artificial approach could have an adverse effect on pricing, on the willingness of underwriters to participate, and on the amount of capacity available at different levels. Accordingly, the provision should be amended to allow insurance companies to determine the levels at which the layering process should occur.

The problem is complicated further by the fact that the term "layering" is not defined. While "layering" of the first $35 million level is prohibited, we believe it is MMS' intent that insurance on a $35 million certificate may be shared by multiple underwriters. This should be clarified because if the first $35 million level cannot be apportioned among underwriters, it is unlikely there will be many insurers willing to subscribe for the full amount.

**JOINT AND SEVERAL LIABILITY**

Since enactment of OCSLA, one of the most troublesome issues connected with financial responsibility for offshore facilities has been the potential joint and several liability of insurers acting as guarantors under federal pollution laws. The possibility that an insurer might be subject to liability for more of a risk than agreed is one of the most serious disincentives to the provision of financial responsibility by the insurance industry. For example, if an insurance company agrees to insure 30% of the first $35 million layer, it does not want to become responsible for the remaining 70%. In fact, some state insurance laws limiting risk exposure could be violated by the imposition of joint and several liability. There needs to be clarification on this point, since the possible imposition of joint and several liability would drastically increase the risk of participating insurance companies, and thus would be an important factor for these companies in determining whether they should enter into the risk in the first place. Neither the insurance form nor the regulations clarify this point.

## INSURANCE FORMS

In setting forth standards for the demonstration of OSFR through insurance, the proposed regulations at times either neglect or misstate prevailing insurance industry standards. This problem becomes particularly acute in connection with the insurance forms under the proposed rule.

If a designated applicant chooses to demonstrate OSFR through the use of insurance, it must submit a certificate which, among other things, lists the insurers and their participating interests. This certificate also permits an insurance agent or broker to sign and presumably bind all participating companies.

This form is fundamentally flawed insofar as it delegates authority to an employee from one company to bind another company. In so providing, the form flies in the face of industry practice in the United States as well as underlying law. One company, not in contractual privity with another, cannot bind the other; no company would agree to such an arrangement. It is true, though, that syndicate managers may bind their members, whether or not the syndicate is foreign or domestic. As for brokers, they are similarly not in a position to bind underwriters. Simply put, brokers are generally agents of the *assureds* and not insurance companies, and do not have nor will they be given the authority to bind the insurance companies on financial responsibility certificates.

We recognize that MMS is attempting to reduce administrative functions through the proposed rules, but the proposed binding authority provisions simply will not work. In light of this reality, the proposed regulations should be amended to reflect industry practice. Although this will obviously create additional administrative burdens, it is necessary given prevailing industry norms and legal relationships among the parties.

## CANCELLATION OF POLICIES

In order to properly calculate their risk, insurance companies must be able to ascertain when their potential liability will (or can) come to an end. Thus, if an insurance company cancels a certificate under the proposed regulations, it needs to know precisely when that cancellation becomes effective. Unfortunately, the proposed regulations are less than clear on this crucial issue.

For instance, under § 253.41(1), an insurance company must agree that the certificate will remain in force until thirty calendar days after MMS and the designated applicant receive its notification of intent to cancel. In addition, § 253.41(2) states that the certificate remains in force until MMS receives from the designated applicant other acceptable OSFR evidence. Although they don't say so explicitly, these two sections, when taken together, could be interpreted to mean that cancellation will not be effective until (i) the requisite thirty days has passed, *and* (ii) MMS has received new OSFR evidence from the designated applicant. This interpretation is wholly unacceptable (not to mention in direct conflict with current OSFR regulations, *see* 35 C.F.R. § 135.207(c) (1996)), for it effectively renders insurance companies powerless to terminate their risk in a timely fashion: since they must wait until new OSFR evidence is provided, insurance companies

OSFR evidence. With the potential for confusion a distinct possibility, it is unreasonable to expect parties to comply within the 60-day period. Indeed, for properties containing numerous leasehold interests, such process of clarification might occupy a significant portion of the 60-day compliance period.

Even assuming that the designated applicant issues can be resolved within a reasonable amount of time, insurance market demands will still make timely compliance extremely burdensome. For instance, if every designated applicant is forced to secure OSFR within this 60-day window, there will be a disproportionately large number of companies searching for insurance coverage simultaneously. This high demand, in turn, will place unprecedented pressure on a relatively small number of energy insurance providers and professionals. If all offshore facilities are to be insured and subsequently renewed at the same time, serious problems relating to accumulation of risk could result. The problem will be accentuated by the fact that many additional facilities in state waters will be seeking financial responsibility at the same time.

Given these considerations, a more prudent approach would be to phase in the new financial responsibility requirements upon renewal of the designated applicant's one-year insurance policy; for multi-year policies, this process could take place on the next anniversary date of the policy. By taking a more gradual approach, the market will have time to adequately respond and adapt to the changing regulatory environment, and designated applicants will be able to secure OSFR in a more normal business environment.

American marine insurers trust that these comments will be helpful to MMS in its reformulation of the regulations. Because we believe that the proposed regulations need major revision with respect to insurance issues, we urge MMS to issue revised proposed regulations giving opportunity for further comment. AIMU would be pleased to arrange a meeting between representatives of our Offshore Risks Committee and energy brokers to provide MMS with additional expertise, if that would be helpful.

In closing, AIMU is grateful for this opportunity to present our views on oil spill financial responsibility under OPA. We would be pleased to provide any additional information that might be helpful to your efforts.

Very truly yours,

Walter M. Kramer

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President